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No. 00-220

In the Supreme Court of the United States

HENRY E. & NANCY HORTON BARTELS TRUST FOR THE BENEFIT OF THE UNIVERSITY OF NEW HAVEN, ET AL., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATESCOURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the tax imposed on the "unrelated business income" of otherwise tax-exempt entities (26 U.S.C. 511-514) applies only when there is proof of actual or potential unfair competition between the commercial activities of the tax-exempt organization and taxpaying entities.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 209 F.3d 147. The orders of the district court (Pet. 22a-30a, 31a-32a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 11, 2000. The petition for certiorari was timely filed on August 7, 2000, pursuant to an extension granted by Justice Ginsburg on June 14, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a tax-exempt organization that was formed to provide funds for a university. Pet. App. 2a-3a. Section 511(b) of the Internal Revenue Code imposes a tax on the "unrelated business taxable income" of tax-exempt entities. 26 U.S.C. 511(b). Under Section 514(a)(1) of the Code, income earned by a tax-exempt organization on property that is at least partially debt-financed is defined as income derived from an unrelated trade or business to the extent it is so financed. 26 U.S.C. 514(a)(1). For this purpose, debt-financed property is defined as "any property which is held to produce income and with respect to which there is an acquisition indebtedness." 26 U.S.C. 514(b)(1). The term "acquisition indebtedness" is defined to include indebtedness incurred in acquiring or improving debt-financed property. 26 U.S.C. 514(c)(1). Regulations adopted pursuant to these provisions specify that securities bought on margin will be considered debt-financed property and that capital gain from the sale of such securities, as well as the periodic dividends from such securities, will be considered income from debt-financed property. 26 C.F.R. 1.514(b)-1(a).

2. Petitioner's trustees had broad discretion in investing its funds. During the 1991, 1992, and 1993 tax years, petitioner invested in securities "on margin," using funds borrowed from its broker. Pet. App. 3a. Petitioner filed returns for its 1991, 1992, and 1993 taxable years showing margin-financed securities income of $417, $2948, and $6123, respectively. *Ibid.* Petitioner paid a tax on this unrelated business income and filed a claim for a refund. *Ibid.* When the Internal Revenue Service denied the refund claim, petitioner filed this refund suit in district court.

3. The district court granted the government's motion for summary judgment. Pet. App. 22a-32a. The court rejected petitioner's argument that the government must show that a failure to impose a tax on this unrelated business income would bestow an unfair competitive advantage on the exempt organization in comparison with taxable businesses. *Id.* at 26a-27a. The court noted that petitioner's argument is based on the erroneous premise that elimination of unfair competition was the sole purpose of the tax on unrelated business income. The court explained that the legislative history of this tax showed that Congress enacted it not only to avoid unfair competition but also to raise revenue from the non-exempt activities of otherwise tax-exempt entities. *Ibid.* The court noted that the statutory language is "framed in broad terms" and that nothing in its text supports a claim that the tax is "limited to the abuse of unfair competition." *Id.* at 27a.

The court also rejected petitioner's additional argument that the tax on unrelated business income covers only periodic income and does not reach the capital gains earned through petitioner's margin trading. Pet. App. 27a-28a. The court noted that there is no basis in the statutory language for any such limitation on the types of unrelated business income to be taxed. *Ibid.*

Finally, the court held that petitioner failed to come within the statutory exceptions for the tax on unrelated business income: (i) the exception for activities "inherent" to the organization's exempt purpose (26 U.S.C. 514(c)(4)) and (ii) the exception for activities "substantially related" to that exempt purpose (26 U.S.C. 514(b)(1)(A)(i)). Pet. App. 28a-30a. The margin securities trading of petitioner was not an activity inherent to the exempt purpose of supporting a university; instead,

ordinary charitable fund-raising activities are the inherent method for that exempt purpose. *Ibid.*

4. The court of appeals affirmed. Pet. App. 1a-21a. The court rejected petitioner's argument that investment in securities is not a "trade or business" encompassed by the tax on unrelated business income. The court noted that Sections 512(b)(4) and 514(a)(1) expressly define income derived from debt-financed property to be "an item of gross income derived from an unrelated trade or business." Pet. App. 8a-9a. The court held that the income from petitioner's debt-financed securities is unrelated business income under the plain language of these statutes regardless of whether it would constitute income from a "trade or business" in other contexts. *Id.* at 9a. The court also rejected petitioner's argument that the tax on unrelated business income does not reach capital gains and, for the reasons given by the district court, held that petitioner's income from securities transactions failed to come within the two statutory exceptions to this tax. *Id.* at 16a-21a.

The court of appeals also rejected petitioner's argument that the government must show that unfair competition would occur in the absence of the tax on unrelated business income. The court noted that no such requirement can be found in the plain language of the statute and that the legislative history showed that Congress enacted these provsions to "'close a tax loophole' and raise additional revenue, as well as to eliminate a form of unfair competition." Pet. App. 10a-11a (quoting *Clarence LaBelle Post No. 217* v. *United States*, 580 F.2d 270, 272 (8th Cir.), cert. dismised, 439 U.S. 1040 (1978). The court also noted that, despite petitioner's contentions to the contrary, no court of appeals has recognized an "unfair competition" require-

ment as a prerequisite for application of the tax on unrelated business income. Pet. App. 14a. The court noted that "the applicable case law reveals that no court of appeals has required such a showing." *Ibid.*

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Petitioner contends that the court erred in concluding that the unrelated business tax may be imposed without a finding that "unfair competition" would otherwise result. Petitioner argues that the sole purpose of Congress in enacting these provisions was to prevent the business activities of tax-exempt entities from gaining an unfair competitive advantage over taxable entities. From that assumption, petitioner draws the conclusion that, notwithstanding the text of the statute, the tax may not apply unless the government establishes that petitioner's trading in margin-financed securities presented a danger to competition. Pet. 7-10.

That contention is plainly incorrect and was properly rejected by the courts below. In the first place, petitioner's premise that the statute was enacted solely to address unfair competition between tax-exempt and taxable entities is incorrect. As the court of appeals correctly concluded (Pet. App. 10a-11a), the legislative history of these provisions shows that Congress had at least two concerns: (i) it wished to curb unfair competition between taxable and exempt entities and (ii) it wished to raise revenue to compensate for tax reductions made elsewhere in the same legislation.

In *Clarence LaBelle Post No. 217* v. *United States*, 580 F.2d 270 (8th Cir.), cert. dismissed, 439 U.S. 1040 (1978), the court also rejected the contentions raised by petitioner here.[1] The court first noted that "[t]he language of the statute does not limit this new source of revenue to only those unrelated trades or businesses that compete with taxpaying entities, for the term is defined as 'any trade or business' unrelated to the exempt purpose of the organization." 580 F.2d at 272. The court quoted several portions of the legislative history—including the President's Message to Congress (96 Cong. Rec. 769, 771 (1950)) and the applicable House and Senate Reports—all of which reveal that Congress was concerned with closing tax loopholes and with raising revenues. 580 F.2d at 272 (citing H.R. Rep. No. 2319, 81st Cong., 2d Sess. 2-3 (1950); S. Rep. No. 2375, 81st Cong., 2d Sess. 2-3 (1950)). The legislative reports specifically linked the need for revenue to the exempt organizations provisions: "The bill provides for substantial reductions in war excise taxes amounting to approximately $1,010 million and contains provisions which make up for the loss of revenue resulting from the excise tax reductions * * * . The major

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[1] The particular issue addressed in *LaBelle* was the tax treatment of bingo games conducted by exempt organizations. After the decision in *Labelle*, Congress added subsection (f) to Section 513 to exempt certain types of bingo games from the tax on unrelated business income. See 26 U.S.C. 513(f); *Louisiana Credit Union League* v. *United States*, 693 F.2d 525, 539 n.29 (5th Cir. 1982); *Pup Tent # 14 Military Order of the Cootie of the United States, Inc.* v. *United States*, 542 F. Supp. 1375, 1376-1377 (D. Minn. 1982). Nothing in Subsection (f) or in its legislative history casts doubt on the general holding of *LaBelle* that a finding of unfair competition is not required for imposition of the tax on unrelated business income.

items accounting for the additional revenue are withholding on dividends, the changes in the tax treatment of charitable and educational institutions * * * ." H.R. Rep. No. 2319, *supra*, at 2-3. See also Mark Larson, *Tax Exempt Organizations and Unrelated Debt Financed Income: Does the Problem Persist?*, 61 N.D. Law Rev. 31, 32 (1985) (the second purpose of passage of the UBIT provisions in 1950 was "to slow the drain of federal tax revenues").

The Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487, added the provisions expanding the reach of the tax on unrelated business income to income from debt-financed property. The House Report on this legislation notes that the debt-financed property provisions were adopted to prevent the abuse represented by the facts of *Commissioner* v. *Brown*, 380 U.S. 563 (1965), in which an exempt organization was able to trade on its tax-exempt status. H.R. Rep. No. 413, 91st Cong., 1st Sess Pt. 1, at 44-46 (1969). The Report concludes "that this type of transaction with its damaging consequences to the Federal revenues *as well as* its potential for unfair business competition should be discouraged." *Id.* at 46 (emphasis added). The legislative history thus makes clear that the tax on unrelated business income is designed not only to prevent unfair business competition but also to avoid the drain on the Treasury resulting from the use of tax-exempt entities to conduct unrelated business operations.

2. Even if the legislative history showed that Congress had only *one* purpose in mind when passing the relevant provisions, the contention of petitioner that the plain text of the provisions could therefore be ignored is incorrect. By their plain terms, these provisions impose the tax on unrelated business income of a tax-exempt entity whenever the exempt organiza-

tion invests in property using debt. See 26 U.S.C. 514(a)(1); page 2, *supra*. Nothing in the statute limits the taxability of such income to situations in which "unfair competition" has been proven to occur. It is a well-established canon of statutory construction that "the reach of a statute often exceeds the precise evil to be eliminated." *Brogan* v. *United States*, 522 U.S. 398, 403 (1998). As this Court emphasized in *Oncale* v. *Sundowner Offshore Services, Inc.*, 523 U.S. 75, 79 (1998):

> [S]tatutory prohibitions often go beyond the principal evil to cover reasonably comparable evils, and it is ultimately the provisions of our laws rather than the principal concerns of our legislators by which we are governed.

See also *Moskal* v. *United States*, 498 U.S. 103, 111 (1990) ("[t]his Court has never required that every permissible application of a statute be expressly referred to in its legislative history").

3. Petitioner errs in contending (Pet. 11-14) that the decision in this case conflicts with this Court's decisions in *Portland Golf Club* v. *Commissioner*, 497 U.S. 154 (1990), *United States* v. *American Bar Endowment*, 477 U.S. 105 (1986), and *United States* v. *American College of Physicians*, 475 U.S. 834 (1986). None of those cases addresses whether "unfair competition" must have occurred before the tax on unrelated business income may be imposed. Moreover, none of the parties in those cases argued that any such requirement existed, for the existence of some type of actual or potential unfair competition was an undisputed fact in all three cases. In those cases, the Court did indeed point out the importance that Congress gave to the danger of unfair competition in enacting the tax on unrelated business income. See Pet. 11. The question whether this tax

would apply only if there is proof of unfair competition, however, was neither at issue nor addressed by the Court in any of those cases.

4. Petitioner also errs in arguing (Pet. 16-18) that a conflict exists among the courts of appeals on the question whether a showing of unfair competition is required before the tax on unrelated business income can be imposed. In fact, no court has agreed with petitioner that such a requirement exists.

For example, in *State Police Association of Massachusetts* v. *Commissioner*, 125 F.3d 1 (1997), cert. denied, 522 U.S. 1108 (1998), the First Circuit held that revenue from advertisements in a state police association yearbook was subject to the tax on unrelated business income even though the association argued that it did not pursue advertisers with enough "entrepreneurial zeal" to constitute a real threat to more professional publications. The court concluded that, "[a]lthough the purpose behind the unrelated business income tax is to create a more level playing field between taxed and tax-exempt enterprises, competitive similarities are not the only factors to be taken into account. * * * The applicable regulation * * * does not require that either actual competition or competitive equality be shown." 125 F.3d at 8 (citing 26 C.F.R. 1.513-1(c)(1)). See also *Julius M. Israel Lodge of B'nai B'rith* v. *Commissioner*, 98 F.3d 190, 194 (5th Cir. 1996) ("We agree with the taxpayer that avoidance of unfair competition was one of the congressional objectives in enacting the tax on unrelated business income, * * * but we have also recognized that the need to stem a substantial loss of revenue, among others, was among the objectives."); *Louisiana Credit Union League* v. *United States*, 693 F.2d 525, 539-542 (5th Cir. 1982) (concluding

that there is no "unfair competition" requirement);[2] *Fraternal Order of Police* v. *Commissioner*, 833 F.2d 717, 722 (7th Cir. 1987); *Illinois Association of Professional Insurance Agents* v. *Commissioner*, 801 F.2d 987, 991 (7th Cir. 1986); *Hope School* v. *United States*, 612 F.2d 298, 304 (7th Cir. 1980).[3] Similarly, the Tenth Circuit held in *National Collegiate Athletic Association* v. *Commissioner*, 914 F.2d 1417 (1990), that in applying the tax on unrelated business income "it is not necessary to prove or disprove the existence of actual competition" and further noted that one of Congress's purposes in enacting this tax was to raise revenue. *Id.* at 1425 & n.9.

Petitioner nonetheless argues (Pet. 16-18) that some courts have issued decisions conflicting with the decision in the instant case. In each of the cases that petitioner cites, however, the existence of potential unfair competition between the tax exempt entity and taxpaying entities was undisputed. Some of these cases merely reflect that unfair competition is a factor that may be considered in deciding whether to impose the tax; they do not hold that the government is required to

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[2] Similarly, in *Southwest Texas Electrical Cooperative, Inc.* v. *Commissioner*, 67 F.3d 87 (1995), the Fifth Circuit held that a nonprofit electrical cooperative must pay the tax on unrelated business income on income it received from transactions in Treasury notes even though such income does not involve competition with the private sector.

[3] Petitioner asserts (Pet. 16 n.7) that *Fraternal Order of Police* had the effect of "overruling, without citation" *Hope School*. Both opinions clearly hold that unfair competition may be considered in determining whether the business activity is unrelated to the charitable purpose of the organization but is *not* a prerequisite for imposition of the tax. *Fraternal Order of Police*, 833 F.2d at 722; *Hope School*, 612 F.2d at 304.

establish the existence of unfair competition before the tax may be imposed. See note 3, *supra*. Several of the other cases cited by petitioner are simply inapposite. For example, petitioner cites (Pet. 16) *Independent Insurance Agents* v. *Commissioner*, 998 F.2d 898 (11th Cir. 1993), which involved an exempt entity—a business league—that sold insurance to public bodies. It was not disputed in that case that these insurance policies competed with those sold by non-members; the issue for decision was instead whether the activities of the business league were within the exception of Section 514(b)(1)(A)(i) for activities "substantially related" to its exempt purposes. 998 F.2d at 901-902. Similarly, in *Oregon State University Alumni Association* v. *Commissioner*, 193 F.3d 1098 (9th Cir. 1999) (cited Pet. 16 n.8), a university alumni association lent its name to an affinity credit card program; the issue was whether the income so derived was royalty income specifically excluded under 26 U.S.C. 512(b)(2), and the opinion mentions unfair competition only as part of a general discussion of the history of the tax on unrelated business income. 193 F.3d at 1101. And, in *American Academy of Family Physicians* v. *United States*, 91 F.3d 1155 (8th Cir. 1996) (cited Pet. 16-17), an exempt physician's organization received income from sponsoring group insurance plans. The organization argued that it should not be subject to the tax on unrelated business income because it was not engaging in a "trade or business," and the district court so found. 91 F.3d at 1157. In upholding this finding, the court of appeals relied on several factors, including profit motivation, the absence of business activity on the organization's part, and the lack of unfair competition with taxable entities. *Id.* at 1157-1159. The court did *not* hold that lack of competition was a controlling factor, as peti-

tioner contends. Indeed, its discussion of other factors would have been superfluous if it had adopted petitioner's claim that unfair competition must be established before the tax on unrelated business income may be imposed.

Petitioner also erroneously relies (Pet. 16-17) on *American Bar Endowment* v. *United States*, 761 F.2d 1573 (Fed. Cir. 1985), rev'd, 477 U.S. 105 (1986), which involved an exempt organization that sold group insurance policies to its members and retained the resulting profits. The parties stipulated that the only issue presented in that case was whether the insurance plan constituted a "trade or business." 761 F.2d at 1576. The court of appeals discussed cases in which exempt business leagues sold insurance in competition with tax-paying insurance agencies, and noted that the presence of unfair competition is a factor in determining whether the business activity was unrelated to the exempt purposes of the organization. *Id.* at 1577. In concluding that the activities involved in that case were not subject to this tax, the court considered the possibility of unfair competition as only one factor among several. *Ibid.* In reversing, this Court relied upon both the commercial nature of the organization's insurance activities and the undeniable potential for unfair competition. *United States* v. *American Bar Endowment*, 477 U.S. at 110-115. The Court stated that the anti-competitive effect of the organization's attempted use of its exemption to conduct commercial activities was "[o]ne obvious consideration" in applying this tax, but the Court plainly did not purport to establish this factor as a prerequisite for application of the tax. See *id.* at 113 n.2.

To the contrary, this Court has repeatedly held that a statute is to be interpreted in accordance with its plain

meaning. See, *e.g.*, *Lexecon Inc.* v. *Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998); *Beach* v. *Ocwen Federal Bank*, 523 U.S. 410, 417 (1998). None of the statutory provisions governing the application of this tax requires the government to prove that the unrelated business activities of an exempt organization present a danger of unfair competition. Nor is such a cumbersome requirement for the administration of the tax liability to be assumed in the absence of support in statutory text.

Petitioner nonetheless asserts (Pet. 8-10) that, in some situations, it is permissible for courts to read requirements into a statute in order to effectuate the legislative intent. There are, of course, limits to any such interpretive theory. See page 8, *supra*. In any event, as we have previously discussed, the legislative history of these statutory provisions does not reflect that Congress enacted this tax solely for the purpose of preventing unfair competition. See pages 5-7, *supra*. As the court of appeals emphasized in this case (Pet. App. 10a-11a), the legislative history also shows that Congress enacted this tax to raise needed revenues.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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